

DESCRIPTION OF THE CONCEPT OF REASONABLE ASSURANCE AND HOW THE EVALUATION WAS CONDUCTED

(TAB A)

The systems of internal accounting and administrative control of the Office of the Secretary of Defense (OSD) and DoD Field Activities in effect during the fiscal year ending September 30, 2002, were evaluated in accordance with the guidance provided by Office of Management and Budget (OMB) Circular No. A-123 (Revised), "Management Accountability and Control," dated June 21, 1995, as implemented by DoD Directive 5010.38, "Management Control Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control Program Procedures," dated August 28, 1996. The OMB Guidelines were issued in consultation with the Comptroller General of the United States, as required by the "Federal Managers' Financial Integrity Act of 1982." Included is an evaluation of whether the systems of internal accounting and administrative control of the OSD and DoD Field Activities are in compliance with standards prescribed by the Comptroller General.

The objectives of the systems of internal accounting and administrative control of the OSD and the DoD Field Activities are to provide reasonable assurance that:

- Obligations and costs are in compliance with applicable laws;
- Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
- Revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets.

The evaluation of management controls extends to every responsibility and activity undertaken by OSD and the DoD Field Activities and is applicable to financial, administrative, and operational controls. Furthermore, the concept of reasonable assurance recognizes that (1) the cost of management controls should not exceed the benefits expected to be derived and (2) the benefits include reducing the risk associated with failing to achieve the stated objectives. Moreover, errors or irregularities may occur and not be detected because of inherent limitations in any system of internal accounting and administrative control, including those limitations resulting from resource constraints, congressional restrictions, and other factors. Finally, projection of any system evaluation to future periods is subject to risk that procedures may be inadequate because of changes in conditions, or that the degree of compliance with procedures may deteriorate. Therefore, this statement of reasonable assurance is provided within the limits of the preceding description.

The evaluation was performed in accordance with the guidelines identified above. The results indicate that the systems of internal accounting and administrative control of OSD

and the DOD Field Activities, in effect during the fiscal year that ended September 30, 2002, taken as a whole, comply with the requirement to provide reasonable assurance that the above mentioned objectives were achieved. This position on reasonable assurance is within the limits described in the preceding paragraph.

The Director of Administration and Management, Office of the Secretary of Defense, serves as the senior management official for the OSD Component, which includes the Office of the Secretary of Defense and the following DoD Field Activities: American Forces Information Service (AFIS), Department of Defense Education Activity (DoDEA), Defense Human Resources Activity (DHRA), Defense Prisoner of War/Missing Personnel Office (DPMO), Office of Economic Adjustment (OEA), TRICARE Management Activity (TMA), and Washington Headquarters Services (WHS). Because of its small size, the Office of Economic Adjustment conducts its MC Program as a part of the Under Secretary of Defense (Acquisition, Logistics, and Technology). This reduces the overhead burden and eliminates separate reporting requirements for this small organization.

Because of the diverse missions of the Field Activities, their determinations of reasonable assurance and evaluations are presented individually. The information for the Office of the Secretary of Defense follows this paragraph. Information pertaining to the Field Activities is presented in separate Tab A submissions, following the OSD Tab A.

OFFICE OF THE SECRETARY OF DEFENSE

The Office of the Secretary of Defense is composed of fourteen reporting organizations with strength levels from nine to more than 480. The organizations include small, single mission offices, such as the Assistant to the Secretary of Defense (Intelligence Oversight), and large, complex, multi-mission organizations, such as the Under Secretary of Defense (Acquisition, Technology, and Logistics). The Office of Force Transformation and the Office of Net Assessment submitted component Statements of Assurance for the first time this year.

Determination of Reasonable Assurance Status

The diversity and independence of the organizations within the Office of the Secretary of Defense present a challenge to the management control (MC) evaluation process. Throughout the OSD, management control evaluations are done concurrently with other required reviews, audits, and inspections to eliminate duplicative evaluations, and minimize the need for “stand alone” management control evaluations. The evaluation of OSD is based on a general assessment of management controls throughout the organization, and considered input from management studies and assessments, audits, inspections, investigations, internal review reports, and Inspector General and General Accounting Office reports. The determination of “Reasonable Assurance” is based on the following factors:

- The MC Program is fully institutionalized within OSD.
- The OSD Principals executed Component Letters of Assurance attesting that their existing management controls are operating as intended by the Federal Managers' Financial Integrity Act of 1982. They have also cited numerous management control accomplishments within their organizations.
- External reviews have cited few deficiencies in the operation of management controls within OSD.
- The management control program is serving the purpose for which it was designed. It has brought material, non-material, and DoD systemic weaknesses to the attention of senior management. Where weaknesses are found, they are acted on and corrected.

The foregoing, as well as the accomplishments listed below, substantiates the conclusion that the MCs in place in OSD are appropriate and effective. The following items provide information on what was considered in evaluating the MC system and provides further support for the conclusion of "Reasonable Assurance."

1. Progress Made in Institutionalizing Management Controls. The MC Program has been in operation within OSD since the passage of the Federal Managers' Financial Integrity Act (FMFIA) of 1982. The OSD Management Control Program Manager provides policy guidance and direction throughout the year, and each OSD Office has assigned a Primary, and in most cases, an Alternate MC officer.

Overall, there have been steady improvements made to the OSD MC program. The OSD offices continue to implement the revised Office of Management and Budget Circular No. A-123, "Management Accountability and Control", as supplemented by DoD Directive 5010.38, and DoD Instruction 5010.40. The MC program has been integrated into the daily operations of the organizations and their management. For the most part, MC evaluations are conducted using Alternative Management Control Reviews (AMCRs), which are done concurrently with other existing audits and reviews. This eliminates duplication and minimizes "stand alone" evaluations that are done solely to comply with MC program requirements. The AMCRs use computer security reviews; quality assessments; financial system reviews; GAO and IG audits, inspections, or investigations; internal review audits and studies; and management reviews.

2. Any Improvements to MC Program Coverage. There is complete coverage of all programs, functions, and activities within OSD and the above-named Field Activities. Effective this year, two small offices, the Office of Net Assessment, and the Office of Force Transformation provided letters of assurance to support the development of the OSD SoA.

As reorganizations occur within offices, assessable units are reviewed and updated. New assessable units are established, as needed.

When new organizations are created, they establish an appropriate MC program, with assistance from the OSD MC Program Manager. For example, the Office of Force Transformation is a new organization within the Office of the Secretary of Defense. The Office of Force Transformation designated a Management Control Officer, as an additional duty. The OSD MC Program Manager provided an orientation on the MC program and all required references to the Office of Force Transformation MC Officer. The assistance included a discussion of reporting requirements and a possible structure for assessable units within this small organization. The Office of Force Transformation MC Officer then established assessable units, conducted appropriate MC evaluations, and completed the necessary documentation to support the preparation of the OSD Statement of Assurance. In this example, the Office of Force Transformation now has a practical and functional MC program that meets the needs of this small, but very important office.

3. Descriptions of the Problems Encountered in Implementing the Program. There were no significant problems encountered in implementing the OSD MC Program. The changes to organizations and the workload associated daily operations placed increased pressure on management control processes. As mentioned earlier, emphasis has been placed on integrating MC requirements into the routine operations of organizations, and eliminating “non-value added” MC requirements. Where additional management controls were needed, the necessary adjustments have been made, and additional management controls have been put in place.

4. Other Program Considerations. The FY 2002 OSD MC program was affected by the recovery operations from the September 11 terrorist attack. This resulted in increased workload, relocation of workspaces, and other operational and mission changes. These activities increased the need for management control oversight in organizations that were heavily engaged in recovery operations.

5. Deviations from the process as outlined in the OMB guidelines. Activities are no longer required to evaluate their controls on the basis of OMB guidelines, but will instead employ OMB Circular A-123 and implementing DoD guidance.

6. Any Special Concerns Addressed in Reports of Audits, Inspections, or Investigations. The reporting organizations did not identify any new concerns that were addressed in audits, inspections, or investigations within the OSD staff during FY 2002. There are several past reports that, because of the major systemic issues involved, are still being addressed by organizations. The USD(AT&L) continues to address process changes needed to correct systemic weaknesses noted in GAO report, GAO-01-479, *DoD Training Range Cleanup Costs Are Underestimated*. The major actions needed to correct deficiencies will be implemented in FY 2003, but it will be FY 2004 before sufficient data will be available to indicate whether or not the issue has been fully corrected.

7. Methods, Mechanisms, or Techniques Employed in the Discovery or Execution Phases of the MC Program.

a. Risk Assessments, MC Evaluations (Reviews). The OSD uses Alternative Management Control Reviews, in accordance with DODI 5010.40, as its primary means of evaluating control techniques. This is consistent with OMB and USD(C) emphasis upon eliminating non-value-added procedures and discouraging the conduct of management control reviews and other MC Program-specific evaluations (unless alternative sources of information are not available). All organizations performed risk assessments of critical areas, and used feedback from other reviews and evaluations.

b. MC Weakness Tracking System. OSD staff organizations use weakness tracking systems to monitor corrective actions, where significant management control weaknesses are noted. The Director of Administration and Management is implementing a tracking system for the first time, to address management control weaknesses identified during FY 2002. The ASD(PA) implemented a weakness tracking system that allows the monitoring of both material and non-material weaknesses from the OASD(PA), the American Forces Information Service, and other subordinate elements. MC Program administrators at each field activity maintain the tracking system, and update the corrective actions. In addition to the new material weakness identified in FY 2002 and the prior year material weaknesses identified in the Cover Memorandum and Tabs B-1 through B-3, staff elements are addressing and correcting lower-level management control weaknesses within their organizations that do not rise to the level of an OSD material weakness. The USD(P&R) reported issues that were considered to be “material weaknesses” within a subordinate staff element, but were not sufficiently material to warrant reporting at the OSD level. These “internal material weaknesses” include:

Organization	Internal Material Weakness Title	Year First Identified	Target Correction Date
USD(P&R) (FMP)	Commercial Life Insurance Sales Procedures in DoD	FY 1999	FY 2003
USD(P&R) (FMP)	Permanent Change of Station (PCS) Lodging Revenue	FY 2000	FY 2003
USD(P&R) (FMP)	Classification of Nonappropriated Fund Activities	FY 1999	FY 2003

c. Component IG Audit Findings, Component Inspections, and DoD IG Reports and Reviews. Reporting organizations did not identify any major management control issues within their organizations attributed to FY 2002 DoD IG audit findings. DoD IG audit findings during FY 2002 continued to identify systemic issues that are being addressed by staff elements. The ASD(C3I) reported that DoD IG audits continue to show that security certification and accreditation of individual information and computing systems and applications within the Department is not adequate. The DoD IG and GAO identified multiple management control weaknesses associated with the DoD travel card and purchase card programs, within the Department as a whole. The purchase and travel card programs were an area of emphasis for internal management control

evaluations for FY 2002. There were no significant MC weaknesses cited by OSD staff principals during their internal evaluations of their card programs. The results of Field Activity evaluations are addressed in the Field Activity Tab A reports. Staff elements continued to address the long-term corrective actions required as a result of previous DoD IG audits. The USD(P&R) continues to monitor corrective actions required as a result of weaknesses noted in DoD IG report 99-106, *Commercial Life Insurance Sales Procedures in DoD*. Past recommendations from DoD IG audits are still being used to improve OSD MC program efforts. The DOT&E uses processes and practices identified in the DoD IG Report 00-150, *Management and Use of Director, Operational Test and Evaluation Funds*, to assist in providing accountability of funds used to support test and evaluation programs.

d. MC Program Training. The Director of Administration and Management maintains a web site with up-to-date references and information on the management control program at <http://www.odam.osd.mil/omp/managementcontrol.htm>. The OSD Management Control Officer provides tailored management control training and assistance throughout the year, as requested by OSD organizations. Individual training was provided for the Office of Force Transformation Management Control Officer to assist this newly-created office in establishing a management control program. The DA&M Management Control Officer provided training on the MC process and reporting requirements to key DA&M personnel in FY 2002.

e. MC Performance Standards. All managers with significant management control responsibilities are required to have MC performance standards in their performance agreements or equivalent military performance planning documents. These managers' FY2002 evaluations reflected their success or failure in implementing and maintaining management controls in their organization.

f. GAO reports and reviews. The GAO completed a review of the proposed policy change to DoD Instruction 1015.2, *Lodging Program Resource Management*. The USD(P&R) staff is incorporating the GAO results into a revised Instruction. The following GAO reports identified management control issues that are being addressed by OSD staff elements:

(1) *Defense Management: Industry Practices Can Help Military Exchanges Better Assure That Their Goods Are Not Made By Child or Forced Labor*, GAO-02-256, January 31, 2002.

(2) *DoD Personnel: Inadequate Personnel Security Investigations Pose National Security Risks*, GAO-NSIAD-00-12, October 27, 1999.

g. Information Technology initiatives. Numerous Information Technology (IT)-related initiatives were reported by the Principal Staff Assistants. Concerns exist, and improvements are being made, in the security of IT systems and websites; the proper use and prevention of piracy of software systems; and the accountability of IT equipment. The ASD(PA) cited the funding received from Washington Headquarters Services for completing DoD Information Technology Security Certification and Accreditation Process and System Security Authorization Agreements as a positive factor in their IT MC program efforts.

h. Command or other subordinate organization “Letters of Assurance”. All Principal Staff Assistants have executed Letters of Assurance attesting to the status of their management controls. Additionally, many staff elements (both large and small) have subordinate elements provide Letters of Assurance as a means of maintaining senior leader visibility over the management control program, and to provide accountability for the management control evaluation processes.

i. “Hot Line” reports. The OSD staff elements did not report any significant management control weakness identified as a result of “Hot Line” reports. When Hot Line reports are received, allegations are investigated and necessary corrective action is taken, as appropriate.

SYSTEMIC WEAKNESSES

Office of the Secretary of Defense Systemic Weakness Disclosure: A summary of the Systemic Weaknesses submitted by the Principal Staff Assistants, as required for input to the Performance and Accountability Report, is provided at Tab D.

The list below summarizes all of the material weaknesses, both corrected and uncorrected, contained in the FY 2002 OSD and Field Activity Statement of Assurance that are related to the DOD Systemic Weaknesses:

DoD Systemic Weakness: DoD Financial Management Systems and Processes

OSD and Field Activity Material Weaknesses related to the DoD Systemic Weakness:

<u>Material Weakness</u>	<u>Reporting Organization</u>
<u>Page</u>	
Disbursements in Excess of Obligations B-2-X	USD(C)

Negative Unliquidated Obligations
B-3-1

TMA

DoD Systemic Weakness: Information Assurance

OSD and Field Activity Material Weaknesses related to the DoD Systemic Weakness:

Material Weakness
Page

Reporting Organization

Information Assurance

DA&M

B-2